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IN THE

Supreme Court of the United States

OCTOBER TERM, 1959

No. 405

PAN AMERICAN PETROLEUM CORPORATION, *Petitioner*,

v.

FEDERAL POWER COMMISSION, *Respondent*.

PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE DISTRICT OF COLUMBIA CIRCUIT

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v.

FEDERAL POWER COMMISSION, *Respondent*.

PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE DISTRICT OF COLUMBIA CIRCUIT

Pan American Petroleum Corporation, on its own behalf, and, under orders of the Federal Power Commission and the judgment below, in a representative capacity for sixty-three other persons,* prays that a

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* Episcopal Theological Seminary of the Southwest; First National Bank of Longview, Texas, as Trustee for the Roy H. Laird Memorial Hospital; The Bishop Quin Foundation; the Methodist Home; (successors in interest to Annie B. Laird, Independent Executrix of the Estate of Roy H. Laird, deceased); Texie B. Davis Musser as Trustee for Jack M. Carson, Jr., (successor in interest to W. Dudley Taylor, Jr., Trustee for Jack M. Carson, Jr.); W. Dudley Taylor, Jr., Trustee for Dudley Davis Taylor;

Writ of Certiorari issue to review the judgment of the United States Court of Appeals for the District of Columbia Circuit entered in the above case on June 18, 1959.

OPINIONS BELOW

The Opinion of the Court of Appeals (*infra*, Appendix A, pp. 1a-21a) is not yet reported. The orders of the Federal Power Commission (R. 3432, 3496), are reported at 19 F.P.C. 519.

JURISDICTION

The judgment of the Court of Appeals was entered on June 18, 1959 (*infra*, Appendix A, p. 22a). The jurisdiction of this Court is invoked under 28 U.S.C. § 1254(1) and § 19(b) of the Natural Gas Act, 15 U.S.C. 717r(b).

Rose Rudman, as Executrix of the Estate of I. Rudman, deceased; Janie R. Strength, as Executrix of the Estate of W. H. Strength, deceased; Bracken Oil Company; J. G. Catlett Company; Fair Oil Company (successor in interest to R. W. Fair); Producing Properties, Inc. (successor in interest to Hollandsworth Oil Co.); Rudeo Oil and Gas Company; Sells Petroleum, Inc.; Skelly Oil Company; Strebor Oil Company; Three States Natural Gas Company; Tintic Standard Mining Company; J. G. Barker; C. M. Beckett, Jr.; J. M. Brown; L. D. Brown; W. H. Bryant; Winifred Chapman; H. H. Coffield; J. L. Copeland; Texie Bialock Davis; Sam B. Hall, Jr.; P. W. Hemphill; E. Fred Herschback; Thelma Higgins; J. S. Hudnall; Arch Jarrott, Jr.; L. C. Johnston; Mrs. R. Bruce Johnston; Franklin Jones, Sr.; M. H. Jones; Hobart Key, Jr.; Will Y. Lancaster; C. A. McLean; Roy Marcom; Ralph Massad; A. B. Miller; Morris H. Moore; Mrs. Beulah A. Ostrom; Jack L. Ostrom; Robert R. Ostrom; Bryan W. Payne; Robert B. Payne; G. W. Pirtle; Ernest E. Smith; Summerfield G. Roberts; Alice Snider; D. H. Snyder, III; Frank Davis Snyder; W. Dudley Taylor, Jr.; Winston Taylor; D. A. Thomas; Sam Trant; Lina H. Van Sickle; Paul L. Whaley; Jack Blalock; and C. A. Brian.

QUESTIONS PRESENTED

1. Whether Section 4(e) of the Natural Gas Act and the Fifth Amendment to the Constitution prohibit determination of reasonableness of the price provided in a gas sales contract unless "cost-of-service" studies are presented, (a) where such sales contract is but one of hundreds of a producer's gas sales contracts and prices in other contracts are not in issue, (b) where the one price in issue is received by more than seventy producers who separately make other sales under other contracts not in issue, and (c) where determination of a "cost-of-service" for the one price in issue would require attempted isolation of a "cost" of only a minute segment of the total business enterprise of each of more than seventy producers.

2. Whether the judicial review to which a petitioner is entitled under Section 19(b) of the Natural Gas Act and Section 10(e) of the Administrative Procedure Act of 1946, is denied when a Court of Appeals affirms Federal Power Commission action on grounds advanced for the first time in the Court of Appeals and fails to review Commission conclusions of law as to statutory and constitutional limitations upon its powers under Section 4 of the Natural Gas Act, specifically challenged by petition for review.

CONSTITUTIONAL PROVISION AND STATUTES INVOLVED

The provisions of the Fifth Amendment to the United States Constitution, and the pertinent provisions of the Natural Gas Act, 52 Stat. 821, 15 U.S.C. § 717, *et seq.*, and of the Administrative Procedure Act of 1946, 60 Stat. 237, 5 U.S.C. § 1001, *et seq.*, are set out in Appendix B, *infra*, pp. 23a-30a.

STATEMENT

This case began less than ten months after the decision on June 7, 1954, in *Phillips Petroleum Co. v. Wisconsin*, 347 U.S. 672 (1954), holding that certain sales by independent producers are subject to regulation under the Natural Gas Act (Act).[1] The order under review, raising issues of statutory and constitutional limitations upon Commission power to determine reasonableness of producers' field prices, is the first such order to reach this Court without an order of remand by a Court of Appeals for further proceedings before the Federal Power Commission (Commission).

1. *Factual Background.* Pan American Petroleum Corporation (Pan American) is engaged in production and sale in the producing fields, of oil, natural gas, gas condensate, and other hydrocarbon products. Its domestic production operations are conducted throughout the producing regions of the southwestern, midcontinent and Rocky Mountain states. It makes over one thousand individual sales of natural gas to pipelines and industries in widely scattered fields.

After the *Phillips* decision, several hundred of Pan American's gas sales contracts became subject to the Commission's jurisdiction, but it was permitted by Commission regulations to file only 150 of these contracts (18 C.F.R. 154.91). Each of the 150 separate contracts was filed as a separate "rate schedule" under

[1] As noted in the *Phillips* case, an independent producer engages in exploration for and production and sale of natural gas, but does not engage in interstate transmission of gas and is not affiliated with an interstate natural gas pipeline company (347 U.S. at 674-675).

Section 4 of the Act (R. 287-290).[2] Among these is the contract covering sale by Pan American of its respective shares in natural gas produced from 33 wells in the Woodlawn Field, Harrison County, Texas (R. 2662).

Operations in this field are conducted in accordance with practices and contractual arrangements both typical of and necessary in the natural gas producing industry. One hundred and fourteen persons have acquired the working interests in leases in the field (R. 2438, 2816-21). The 114 persons thus own interests in the gas and other commodities produced in common streams from 49 wells on these leases. Each owner of such an interest is also engaged in various other activities, and most of these persons, like Pan American, make interstate and intrastate sales of natural gas in numerous other fields in Texas and other states (See *e.g.*, R. 741-2, 757, 767, 777). However, the individual interests of these owners in the gas producing wells in the Woodlawn Field vary widely from well to well, ranging, for example, from 91.87% to 0.15% in one well and from 31.76% to 0.63% in another. Some of the producers own an interest in only one or two wells; others own interests in several wells, and still others own interests in most of the wells (R. 2816-21). Under arrangements which are customary in the industry,

[2] At the time of filing, the name of the company was Stanolind Oil and Gas Company. It was then making 1,035 separate sales of gas, of which 701 were under "percentage-type" agreements which are not filed as "rate schedules" under Commission regulations; 184 were sales not subject to Commission jurisdiction; and 150 were sales for which contracts were filed as "rate schedules." After merger with another company in 1957, the name was changed to Pan American Petroleum Corporation. The company now has more than 250 sales contracts on file as "rate schedules."

Pan American, the owner of the largest interests, operates 33 wells under agreements with the more than 70 owners of interests in these particular wells; there being a separate operating agreement for each well. Each owner retains a voice in operation of each well in which he owns an interest. Each owner also has the right to sell his share of gas production, including the right to cancel, on short notice, any sales arrangement made with respect to his gas by the operator. The operator is authorized to sell a non-operator's share only when the non-operator fails to dispose of his share as currently produced (R. 74-75, 120-21).

In April, 1951, Pan American executed a twenty-year contract to sell its respective shares of the gas produced from the 33 wells to an interstate pipeline company, which, even after extension of its line into the field, was, for several years, the only pipeline purchasing gas in the immediate area. Thereafter, the majority of the other owners elected to sell their respective shares under terms of the Pan American contract without formal execution of a separate instrument (R. 73, 107, 231). Under these arrangements, Pan American, as operator, delivers the undivided well streams to the one purchaser, and transmits to each owner his shares of proceeds from the gas sales (R. 107-8, 2805-2821).

2. *The Commission proceeding.* Under Commission regulations, producers who are not signatory parties to a sales contract are not permitted to file a "rate schedule," and the contract which is the "rate schedule" of a signatory owner, usually the operator, is deemed to be that of each of the other owners (18 C.F.R. 154.91). Pan American's contract covering deliveries in the

Woodlawn Field, therefore, is designated "Pan American Petroleum Corporation (Operator), *et al.* FPC Gas Rate Schedule No. 31;" and filings or Commission orders concerning this schedule apply equally to the price received by Pan American and to the price received by each of more than 70 non-operating owners who are *not* permitted to file their own schedules.

In March, 1955, on behalf of itself and the non-operating owners, Pan American filed with the Commission a notice that under the contract the price would increase on April 3, 1955, from 13 to 13.5 cents per thousand cubic feet (Mcf) (R. 2805). On April 1, 1955, the Commission issued an order suspending the increase as a change of the "rate schedule," and directing that a hearing be held to determine the reasonableness of the increase under Section 4(e) of the Act (R. 3069). During the hearing, Pan American and a non-operating producer introduced extensive factual evidence in support of the one price in issue. The producers did not present evidence in the form of the "conventional cost-of-service" used in the past in proceedings where the whole body of rates of a pipeline or utility have been in issue.[3] A comprehensive showing was

[3] The "conventional cost-of-service" concept, under Commission practice, requires the determination of a "rate base" consisting of each individual company's capitalized investment and working capital; the calculation of the company's proper "rate of return" upon its investment in jurisdictional activity; and the determination of the company's annual operating expenses and depreciation and depletion charges, which, with the return on the "rate base" and tax allowances, generally comprise an annual "cost-of-service." These calculations require, among other detailed steps, an allocation of costs directly or indirectly associated with jurisdictional activity, an allocation of general administrative overheads and exploration and developments costs, an allocation of investment and expenses between jointly produced commodities

made as to the impossibility of presenting evidence in the "cost-of-service" form because of the nature of the producing industry, including data as to the number of owners, problems of "allocating" costs to gas produced with unregulated commodities from the same wells, wide variations in total costs of acquiring lease interests, etc. (R. 287, 1276-7, 1286-96, 1300-15, 1842-50).

Before the Commission, the producers argued that in review of a producer's sales price, the Commission was not bound by law to any single rate-making formula or combination of formulae, but was free to devise rate review procedures which recognized the distinctive characteristics of the gas producing industry. The producers also argued that neither the Act, nor constitutional prohibitions against imposing confiscatory rates, required presentation of "cost-of-service" evidence.

On April 14, 1958, the Commission entered an order disallowing the half-cent increase (R. 3432). By adoption of its Examiner's findings, the Commission concluded, *inter alia*, that there was no affiliation between

to attribute a portion to natural gas, determination of tax liabilities and working capital requirements, and analysis of individual "return requirements" which can be based only upon the revenue requirements and earning capacity of all of the company's jurisdictional activities. Evidence submitted by the producers included, but was not limited to, objective data showing the competitive negotiation of the contract price, the commodity value of the gas in the competitive market, statistical analyses of trends in costs and price levels in the competitive market, absence of impact of the increase upon value of the gas to the purchaser and upon a consumer, and other circumstances and conditions surrounding the sale. (See R. 61-65, 72, 76-84, 396, 405-16, 1829-1836, 1870-1892, 2200, 2203, 2221, 2521, 2526, 2527, 3302).

the producer-sellers and the buyer; that the contract was entered into at arm's length in a competitive market; that the evidence indicated that the half-cent escalation would not have a "substantial impact" upon ultimate consumers; that the evidence was such that inference could be drawn that "numerous practical difficulties would accompany an attempt to apply a rate base, cost-of-service formula . . ."; and, that the contract price "falls within the range of prices paid to other producers in the pricing area" (R. 3302-03, 3305-08).

However, the Commission also adopted the Examiner's conclusions of law upon the question of its power (R. 3307-3308):

> ". . . The central issue presented is one of constitutional requirements, and of our statutory power. The Applicants claim that the Act does not limit the Commission to the use of any particular formula or combination of formulae in determining just and reasonable rates under Section 4(e)."

The Commission held that both the Act and the Constitution impose "requirements" that it consider "cost-of-service" evidence, regardless of the scope of the rate inquiry; that because the producers had not submitted such evidence, the record was deficient in terms of both the Act and the Constitution, and it was legally impossible for the Commission to pass upon reasonableness of the contract price; that, by failing to meet this statutory and constitutional "requirement," the producers, as a matter of law, had not shown the price to be "just and reasonable"; and, that, for these

reasons, the contract price must be disallowed (R. 3307, 3308, 3435).[4]

Rehearing was sought under Section 19(a) of the Act, but was denied, two of the five Commissioners dissenting (R. 3439-3453, 3500).

3. *The petitions for review.* Sixty-four non-operating owners and Pan American sought review under Section 19(b) of the Act in the United States Court of Appeals for the District of Columbia Circuit.[5]

The petitioners challenged as erroneous the conclusion of law upon which the Commission's order was predicated—that the statute and the Constitution require consideration of "cost-of-service" evidence. Specific reference was made to Commission error in failing to follow the principles of law that where only one of many of a regulated company's rates is in issue (1) application of the standard of reasonableness is

[4] In addition to the conclusions of law set forth in their orders, both the Examiner and the Commission referred to conclusions of law set forth in Re *Union Oil Company of California*, 16 F.P.C. 100, 110, 111 (1956) which was reviewed and remanded for further proceedings, *sub nom. Bel Oil Corporation, et al. v. Federal Power Commission*, 255 F. 2d 548 (5th Cir. 1958), *cert. den.*, 358 U.S. 804 (1958).

[5] A joint and several petition was filed by Pan American and sixty three non-operating owners. A separate petition was filed by Continental Oil Company, a non-operating owner which, with Pan American, is signatory to the contract. Upon motion by the Commission, the Court dismissed the petition as to the owners who, under Commission regulations, may not file separate rate schedules, on the ground that these owners were not formal parties. As the Commission itself advised the Court of Appeals, the result of this dismissal was and is that while Pan American proceeds on behalf of the other owners in a representative capacity as required by regulation, each and all of the non-operating owners remain bound by Commission orders.

not, as a matter of law, dependent upon consideration of "cost-of-service" evidence, and (2) the company-wide "end result" test of "revenue requirements" or confiscatory rates, cited by the Commission as controlling, is inapplicable. Whether "cost-of-service" evidence would not be required, as a matter of law if all of a producer's sales were in issue, was not before the Court.

The Commission brief did not undertake to defend the legal conclusions which were the sole basis for the order below, although there was no indication the Commission itself had actually abandoned these conclusions. The Commission's brief urged that the Court need not decide whether the conclusion of law (that the Commission had no power to act upon the record) was erroneous; instead, it was argued that the order should be affirmed as though the Commission had exercised its administrative discretion and thereby had concluded that the price was not just and reasonable, *e.g.*:

> "Whether or not the Commission was *required* to hold 'cost' evidence necessary to petitioners' case, under the controlling judicial authorities need not be decided. The fact is, that the Commission *did* so hold, and its refusal to accept petitioners' rates as 'just and reasonable' was an action at least within the scope of its discretion."[6]

It was also argued, just as the producers had urged before the Commission itself, that "[t]here is much

[6] Brief for Respondent Federal Power Commission below, p. 10. Emphasis was the Commission's.

latitude allowed the Commission in its selection of criteria."[7]

4. *The Court of Appeals opinion.* Regarding the issues raised here, the Court of Appeals first assumed that the petitioners were correct as to embodiment of the historic zone of reasonableness in the "just and reasonable" standard, and as to the distinctions between application of that standard to test one specific rate, and the judicial test of barely non-confiscatory or "lowest reasonable" rates. However, the Court then ignored the controlling questions raised by the petitioners and substituted a different question:

> "The question . . . is whether the petitioners' evidence is sufficient to compel us to reverse the Commission's conclusion that the evidence was not enough to sustain the proposed increase."

Brief reference was then made to decisions recognizing the breadth of administrative discretion in rate regulation, which, however, related to the broader questions of judicial tests employed in review of constitutionality of orders fixing system or company-wide rates for monopolistic or semi-monopolistic enterprises. The specific and controlling issue raised—whether "cost-of-service" evidence is, as a matter of law, required where but one among many of a producer's rates is in issue—was not considered. No reference was made to precedents applicable to such rate proceedings of limited scope, which establish that the line of authority cited by the Court actually has no applicability in such proceedings. The Court concluded by affirming the order and noting approval of a "requirement" for

[7] See *Gulf Oil Corporation, et al.* v. *Federal Power Commission*, 255 F. 2d 556, 557 (5th Cir. 1958).

"cost-of-service" presentations as "reasonable," but without analysis of the Commission's conclusions of law that both the Act and the Constitution, rather than Commission discretion, impose such a "requirement" in proceedings of limited scope under Section 4 of the Act.

REASONS FOR GRANTING THE WRIT

1. The Court of Appeals has erred in affirming a Commission order based solely upon conclusions of law which are in conflict with principles of law established by this Court and lower federal courts as to:

(a) application of the "reasonableness" standard of rate regulation to test a rate which is but one of many of a regulated company's rates (*e.g., Baltimore and O. R. Co.* v. *United States*, 345 U.S. 146 (1953); *Northern Pacific R.R. Co.* v. *Dept. of Public Works*, 268 U.S. 39 (1925); *Illinois Central R. Co.* v. *Interstate Commerce Commission*, 206 U.S. 441 (1907); *Chicago Board of Trade* v. *United States*, 223 F. 2d 348 (D.C. Cir. 1955); *Pan American World Airways, Inc.* v. *Civil Aeronautics Board*, 256 F. 2d 711 (D.C. Cir. 1958), *cert. den.* 358 U.S. 836 (1958)); and

(b) "constitutional requirements" for "cost-of-service" evidence in proceedings limited to the issue of reasonableness of but one of many of a company's rates. (*e.g., Baltimore and O. R. Co.* v. *United States*, 345 U.S. 146 (1953); *Chicago Board of Trade* v. *United States*, 223 F.2d 348 (D.C. Cir. 1955); *RCA Communications* v. *United States*, 43 F. Supp. 851 (S.D.N.Y. 1942)).

By affirming the Commission, the Court of Appeals, in effect, approves imprecise conclusions of law and

decisional inconsistencies as to statutory "requirements", criticized by the United States Court of Appeals for the Fifth Circuit in ten analogous independent producer rate cases remanded to the Commission for further proceedings.[8]

2. The Court of Appeals has erred in failing to review the conclusions of law which were the agency's only decisional grounds, and in affirming the order on grounds advanced for the first time during the process of judicial review. The Court thus violated the principles laid down in *Sunray Mid-Continent Oil Company* v. *Federal Power Commission*, 353 U.S. 944 (1957); and *Securities & Exchange Commission* v. *Chenery Corp.*, 318 U.S. 80 (1943).

3. The decision of the Commission and the opinion of the Court of Appeals raise questions of both legal and economic significance at the inception of federal regulation of prices of natural gas in the fields of production. Section 4(e) of the Natural Gas Act permits various rates to be fixed by separate, individualized contracts for each sale by a producer.[9] Under the

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[8] See *Bel Oil Corporation, et al.* v. *Federal Power Commission*, 255 F. 2d 548 (5th Cir. 1958); *Sun Oil Company* v. *Federal Power Commission*, 255 F. 2d 557 (5th Cir. 1958); *Gulf Oil Corp., et al.* v. *Federal Power Commission*, 255 F. 2d 556 (5th Cir. 1958); *Associated Oil & Gas Co.* v. *Federal Power Commission*, 255 F. 2d 555 (5th Cir. 1958); *Forest Oil Corporation, et al.* v. *Federal Power Commission*, 263 F. 2d 622 (5th Cir. 1959); *H. F. Sears, et al.* v. *Federal Power Commission*, 263 F. 2d 626 (5th Cir. 1959). Compare the Court's references to *Re Pan American Petroleum Corp., et al.* 19 F.P.C. 463 (1958), (decided only ten days prior to Commission decision in the instant *Pan American* case) in the *Bel Oil Corporation* case, and to the Commission's position in the *Forest Oil Corporation* case.

[9] See *United Gas Pipe Line Co.* v. *Mobile Gas Service Corp.*, 350 U.S. 332 (1956).

Commission's conclusions of law in the instant case, proceedings under that section, limited to the question of reasonableness of one price in one contract, cannot be decided expeditiously. Instead, these proceedings must be held in abeyance for years while an attempt is made to pinpoint a "cost-of-service" or "revenue requirements" based, of necessity, upon thousands of other sales prices and unrelated business transactions not in issue. Whether this effort is required by the Act and the Constitution, or, alternatively, whether the Commission has the power to decide the issue of reasonableness by reference to other objective types of evidence, is a controlling issue in more than 2,300 independent producer rate proceedings now pending under Section 4(e) of the Act.[10] The holding below has interjected further confusion and uncertainty.

Review by this Court is essential to correct errors of law and to clarify Commission power in rate regulation—an area which is fundamental to the administration of the Natural Gas Act and to the sales activity of the natural gas producing industry.

I. The Court of Appeals and the Commission Have Misconstrued Decisions by This Court and Failed to Follow Precedents Applicable Where But One of Many of a Regulated Company's Rates Is in Issue.

The issues before the Court of Appeals were, we believe, of first impression under the Natural Gas Act. In the development of rate regulation, however, agencies and the courts have considered the specific problems of applying the standard of "reasonableness"

[10] Federal Power Commission Release No. 10,568, G-5562 (PUB), August 12, 1959, states that of 39,398 independent producer rate filings tendered between June 7, 1954, and July 31, 1959, 2,354 price changes were suspended and still pending as of July 31, 1959.

to test a rate for a single sale or "service" which is but a small segment of a regulated company's activities.

Like producers of natural gas, the vast number of businesses now subject to rate regulation, including air carriers, railroads, motor carriers, and crude oil pipelines, characteristically are engaged in a wide variety of activities performed at various rates, many of which are influenced by competitive transportation and market conditions. Other regulatory bodies, unlike the Federal Power Commission in this case, have construed the "reasonableness" standard as permitting a decision where but one rate is in issue by reference to such objective and probative factors as value of service, value of the commodity involved, comparisons with other rates, economic circumstances, and impact of the rate upon an ultimate market.

The courts have considered and recognized the practical and legal foundations for such statutory construction, both of which are highly pertinent in this and other independent producer rate cases under Section 4(e) of the Act: first, it is virtually impossible to determine a separate "cost-of-service" for but one rate of many hundreds of rates; and second, where but one among many rates is in issue, tests of constitutionality of rate orders, measured by rates of return or earnings of a system or a company as a whole, are not applicable.

Both commissions and courts have recognized that the "reasonableness" standard grants this latitude to a regulatory body because ". . . mathematically precise calculations of rates of return and costs cannot be made in respect to minute segments of a huge business . . ." and ". . . to achieve a fair rate of return for a whole

system, composed of many services, the rates on some services must necessarily be above the norm and on other services below it."[11]

These constructions of the "reasonableness" standard are within the framework of the broader, and virtually uniform, holdings that the standard consists of a zone within which an agency is free, as a legislative

[11] *Chicago Board of Trade* v. *United States*, 223 F. 2d 348 (D.C. Cir. 1955). In that case involving the reasonableness standard in the Federal Communications Act, the Court of Appeals briefly referred to the development of this rule of "well-established law." As the Court concluded, the "standard" set for system-wide determinations in *Federal Power Commission* v. *Hope Natural Gas Co.*, 320 U.S. 591 (1944), is inapplicable to determination of "a single rate among many rates," which is a "charge for a single service among many services and involves a very small segment of the carrier's business." The Court traced the rule from the Interstate Commerce Commission's construction in 1905 that reasonableness of such a single rate depends upon "'the value, volume and other characteristics affecting the transportation of that particular commodity.'" Recognition of the rule was noted in *Illinois Cen. R. Co.* v. *Interstate Commerce Commission*, 206 U.S. 441 (1907), and in *Northern Pacific R.R. Co.* v. *Dept. of Public Works*, 268 U.S. 39 (1925), and by the Commerce Court in *Lehigh Valley R.* v. *United States*, 204 Fed. 986 (Comm. Ct. 1913). See also *Interstate Commerce Commission* v. *Union Pacific Ry. Co.*, 222 U.S. 541, 549 (1912); *Dayton-Goose Creek R. Co.* v. *United States*, 263 U.S. 456 (1923); *Brundred Bros.* v. *Prairie Pipeline Co., et al.*, 68 I.C.C. 458 (1922); *Pan American World Airways, Inc.* v. *Civil Aeronautics Board*, 256 F. 2d 711 (D.C. Cir. 1958); *Chicago M., St. P. & P. R. Co.* v. *Board of R. R. Comm'rs.*, 255 P. 2d 352 (Sup. Ct. Mont. 1953), and SHINN, REASONABLE FREIGHT RATES, p. 107 (1952). In contrast to this rule, the Federal Power Commission's construction of Section 4(e) of the Natural Gas Act was that reasonableness of a single rate cannot be decided unless the evidence shows whether the rate satisfies the "end result" test in *Federal Power Commission* v. *Hope Natural Gas Co.*, *supra*. But cf. *Re Pan American Petroleum Corp.*, 19 F.P.C. 463 (1958); *Federal Power Commission* v. *Sierra Pacific Power Co.*, 350 U.S. 348 (1956); *Market Street Railway Co.* v. *Railroad Commission*, 324 U.S. 548 (1945).

matter, to find various rates to be just and reasonable.[12] There is no requirement that every rate be at the pinpoint of confiscation—*i.e.*, "the lowest reasonable rate."

The cognate question of whether, as the Commission concluded in this case, there is a constitutional "requirement" for "cost-of-service" studies in all cases was considered in *Baltimore and O. R. Co.* v. *United States*, 345 U.S. 146 (1953), but this Court's holding was not followed by the Court of Appeals below. The Interstate Commerce Commission had fixed maximum rates for but one type of service without reference to "cost-of-service" evidence. In attacking the Commission order in the District Court, the carrier's sole basis for a charge of confiscation was an allegation that the rate prescribed would produce less revenue than alleged "costs" shown by studies proffered in the District Court. This Court enumerated the many factors considered by the Commission relating to value and other circumstances, and held that there was no requirement even for consideration of "cost-of-service" studies, and that the due process clause of the Fifth Amendment cannot be construed as a bar to fixing

[12] The Court of Appeals below merely assumed the existence of this zone of reasonableness, although it has been recognized by the Courts for more than half a century. As stated by Mr. Justice Cardozo in *United States* v. *Chicago, M., St. P. & P. R. Co.*, 294 U.S. 499, 506 (1935): "There is no suggestion in the report that the rates have been so reduced as to be less than compensatory. True they do not reach the maxima beyond which charges are excessive. On the other hand, they do not pass the minima beyond which charges are too low. A zone of reasonableness exists between maxima and minima within which a carrier is ordinarily free to adjust its charges for itself." See also *Montana Dakota Utilities Co.* v. *Northwestern Public Service Co.*, 341 U.S. 246, 251 (1951); *Denver Union Stockyard Co.* v. *United States*, 304 U.S. 470 (1938); *Banton* v. *Belt Line Ry. Corp.*, 268 U.S. 413 (1925); *Simpson* v. *Shepard*, 230 U.S. 352 (1913).

rates without reference to "cost-of-service" for a single service.[13]

Similarly, the issue in this case under Section 4(e) of the Act was limited to reasonableness of a price for a sale which is but one of hundreds of sales by Pan American subject to the Commission's jurisdiction. For each of the other owners, whose sales are covered by the single rate schedule under Commission regulations, the price in issue is for a sale which is also but one of their many business transactions, including hundreds of other sales of natural gas in various other fields, many of which are subject to Commission regulation. The substantial question of whether there would be no constitutional or statutory requirement for "cost-of-service" evidence if all of the regulated sales prices of a producer were in issue, was not before the Commission or the Court of Appeals, and is not before this Court. *Cf. Market Street Railway Co.* v. *Railroad Commission*, 324 U.S. 548 (1945). However, as to the one price in issue, it is obvious that determining a so-called "cost-of-service" would require the attempted isolation of a "cost" for the one sale from the total costs and revenues of the en-

[13] Among the factors were value of the commodity, comparison of commodity values, comparison of rates on the same commodities, comparisons with other rates on other commodities, special characteristics of the service, competing rates, and the possible effect of rates upon prices in ultimate markets (345 U.S. at 149-150). This Court's opinion recognizes that neither the "just compensation" nor "due process" clauses impose such an inflexible "requirement" (345 U.S. at 148). See also *Railway Express Agency* v. *United States*, 6 F. Supp. 249, 253 (S.D.N.Y. 1934), and cases cited in fn. 11, *supra*, reviewing rate determinations under federal regulatory statutes.

tire business activities of each of the many producer-sellers.[14]

Despite this, the Court of Appeals apparently failed to recognize that the Commission reached specific conclusions as to statutory and constitutional "requirements" for "cost-of-service" evidence. It was clear on the face of the order under review that the Commission had construed Section 4(e) of the Act as universally restricting its power to act unless "cost-of-service" studies are presented. Equally clear was the Commission's conclusion that, contrary to the principles applicable where but one among many rates is in issue, it could decide the case only by application of the "end result," or *Hope* test, and that a decision without reference to "cost-of-service" studies or "revenue requirements" of the producers' whole operations, would be proscribed by the Fifth Amendment.

The validity of these Commission conclusions was raised in the petition for review, the briefs and in oral argument, but these controlling issues were not considered below. The Court referred only to inapplicable general criteria employed at times by the judiciary when constitutionality of an order prescribing a whole body of rates has been in issue. Precedents applicable to a rate proceeding of limited scope, such as under Section 4(e), were not considered. In view of the controlling issues raised by the Commission's order and the number of producers involved, the Court of Appeals' references to a showing by "petitioners," in the plural, as to "its" operations, in the singular, and, again to the needs of the "gas companies," in

[14] Cf. Re *Pan American Petroleum Corporation, et al.*, 19 F.P.C. 463 (1958).

the plural, and "its" costs, in the singular, engender further uncertainty, rather than clarify the requirements to be met under Section 4(e) of the Act.

The Commission's conclusions as to limitations upon its powers in proceedings under Section 4(e) were patently erroneous, and the Court of Appeals has erred in not reversing the Commission. Unless this Court corrects these constructions of the Act and conclusions of law as to constitutional "requirements" in proceedings of limited scope, both independent producers and the Commission will remain enmeshed in disorder which has already prevailed for more than five years.

II. The Court of Appeals Deprived Petitioner of the Substance of Judicial Review by Failing to Consider the Questions Raised by the Commission's Decision, and by Affirming the Commission's Order Upon Grounds Advanced for the First Time Before the Court.

The question before the Court of Appeals for adjudication was whether the Commission's constructions of the statute and the Constitution were correct. In clear and unmistakeable language, the Commission had held, as a matter of law, that conventional "cost-of-service" evidence is a statutory and constitutional prerequisite to the exercise of its discretion to decide upon reasonableness of a rate, and that it was required to deny the producers' instant rights to the price in issue solely because of the absence from the record of such "cost-of-service" evidence.

Nevertheless, in the Court of Appeals, the position taken by the Commission's brief was that the Commission, in its discretion, had found such evidence to be necessary to justify a price increase. The order thus was not defended upon the grounds upon which it was actually predicated. Instead, it was argued

that had the Commission correctly construed the scope of its discretion, in exercising that discretion it could have reached the same conclusion, and that, as a consequence, the order should be held valid as an exercise of discretion.

During the briefing process, the Commission's departure from its decisional grounds, and virtual abandonment of the conclusions below, was called to the attention of the Court of Appeals. Despite this, the Court of Appeals ignored the controlling issues clearly raised by the Commission's holding, and substituted as the issue before it, the question of whether the "evidence is sufficient to compel" reversal of the Commission order. Proceeding from this substitution, the Court then affirmed, ostensibly as a "reasonable" requirement by the Commission in its discretion what the Commission itself had actually held as a matter of law to be requirements imposed by the statute and the Constitution.[15]

The Court of Appeals thus deprived the petitioners of the substance of judicial review. An administrative order was based upon constructions of the statute and the Constitution; on review, petitioners challenged the validity of the order on the grounds that these conclusions, which were the exclusive basis for the order, were erroneous. Under the review procedure, if the Court found the Commission's conclusions of law to be incorrect, the Court's duty was to lay bare the error of law and remand the case for further consideration of the evidence by the Commission. Whether an identical order of denial of the increase as unjustified by

[15] Compare the statement of the "central issue" and decisional grounds in the Commission's orders, *supra*, p. 9, with the statement of the question by the Court of Appeals, *supra*, p. 12.

the evidence would have been valid, *if* the Commission had reached that conclusion as an ultimate finding of fact in exercising its discretion, was not the question before the Court. The Commission had concluded that a legal condition precedent was unsatisfied, and the evidence in the case had never been weighed in terms of administrative discretion.[16]

Unquestionably, under the decisions of this Court, petitioners are entitled to independent judicial review of conclusions of law which are an agency's decisional grounds.[17] Section 19(b) of the Natural Gas Act and

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[16] Before the Commission, Pan American explicitly requested the Commission, by findings and conclusions, to make clear what its decision as to reasonableness of the price, upon the evidence presented, would have been, had the Commission not held that, as a matter of law, "cost-of-service" was required. Just as explicitly, the Commission held that such findings and conclusions were "of no moment," since "under the law," "cost-of-service" evidence was required. (R. 3498-3499).

[17] As stated in *Stark* v. *Wickard*, 321 U.S. 288, 310 (1944), the courts, under Article III, are established "to adjudicate cases and controversies as to claims of infringement of individual rights whether by unlawful action of private persons or by the exertion of unauthorized administrative power." When the Federal Power Commission, existing under Article I, deprives individuals of vested contract rights, judicial review must be accorded those aggrieved thereby. *Cf. Keller* v. *Potomac Electric Power Co.*, 261 U.S. 428 (1923). Legislative history of the Administrative Procedure Act clearly discloses the intention of Congress to preserve independent review of actions of such agencies, despite the vast administrative powers delegated. Under Section 10(e), "[r]eviewing courts are required to decide all relevant questions of law, interpret constitutional and statutory provisions, and determine the meaning or applicability of any agency action. • • • This section provides that questions of law are for courts rather than agencies to decide in the last analysis and it also lists the several categories of questions of law." Administrative Procedure Act, Legislative History, Sen. Doc. No. 248, 79th Cong. 2d Session, 278 (1946):

Section 10(e) of the Administrative Procedure Act establish procedural avenues, but, as this case exemplifies, whether the substance of judicial review is actually accorded, must, in the last analysis, depend upon whether the Courts of Appeals follow the precepts of review this Court has laid down in many contexts.

Well-defined are the rules of court-agency relationships that it is a judicial function to decide the limits of statutory power,[18] and that if an agency decides a matter upon conclusions of law, its decision must stand or fall upon the legal validity of those conclusions.[19] Applying these rules in specific cases, this Court has prohibited affirmance of agency orders upon substituted decisional grounds, and, under the Natural Gas Act, has struck down, regardless of the subtleties employed, substitution of questions and decisional grounds by parties or by the Court of Appeals, *sua sponte*, during the course of judicial review.[20] Only two years ago,

[18] Aside from the "law-fact" distinctions, it is settled that even when it construes a statute, an agency is still acting "legislatively," and the statutory construction ultimately is a judicial function. See *Social Security Board* v. *Nierotko*, 327 U.S. 358 (1946); *Addison* v. *Holly Hill Fruit Products*, 322 U.S. 607 (1944), *reh. den.* 323 U.S. 809 (1944); *United States* v. *Rosenblum Truck Lines*, 315 U.S. 50 (1942); *Stark* v. *Wickard*, 321 U.S. 288 (1944).

[19] *Securities & Exchange Commission* v. *Chenery Corp.*, 318 U.S. 80 (1943).

[20] *Federal Power Commission* v. *Colorado Interstate Gas Co.*, 348 U.S. 492 (1955). Other cases have emphasized that the judicial function does not extend to approval of Federal Power Commission action upon grounds not clearly stated in the Commission's orders. See *Connecticut Light & Power Co.* v. *Federal Power Commission*, 324 U.S. 515 (1945); *Federal Power Commission* v. *Idaho Power Co.*, 344 U.S. 17 (1952) *reh. den.* 344 U.S. 910 (1952); *Federal Power Commission* v. *Pacific Power & L. Co.*, 307 U.S. 156 (1939).

this Court held that a court exhausts its powers under Section 19(b) of the Act when it finds Commission construction of the statute to be erroneous, and that it is error for a court to proceed further and affirm the Commission upon other grounds. *Sunray Mid-Continent Oil Company* v. *Federal Power Commission*, 353 U.S. 944 (1957).

The Court of Appeals below has violated these directives, and petitioner here and the persons it must represent thus have been subjected to what apparently has become a four-step pattern in independent producer rate cases and to which the Court of Appeals for the Fifth Circuit has already obliquely referred.[21] First, an order is based upon broadly stated constructions of the Act and the Constitution and conclusions of law that the Commission has no discretion to act;[22] second, this order is not defended in the Court of Appeals upon the stated decisional grounds, but upon the entirely different ground that there has been a proper exercise of discretion on particular facts; third, a Court of Appeals, without analysis of the stated conclusions of law but also without clearly stating its grounds, affirms the order, apparently as a proper exercise of administrative discretion upon the evidence in the case; fourth, the Court's opinion is thereafter cited as specifically affirming the agency's original, broad statutory constructions and conclusions of law that no discretion exists.[23]

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[21] Compare *Bel Oil Corporation* v. *Federal Power Commission*, 235 F. 2d 548 (5th Cir. 1958) and *Forest Oil Corporation* v. *Federal Power Commission*, 263 F. 2d 622 (5th Cir. 1959).

[22] See decisional grounds, *supra*, pp. 9-10.

[23] For example, within four days after the issuance of the Court's opinion in this case, that opinion was cited not as affirming discretion of the Commission to require and consider either "cost-of-

All four steps in this pattern have already been applied in this case and will continue to be applied unless this Court directs the federal courts to accord to petitioner and others similarly situated, the full, independent judicial review of agency conclusions of law required by Section 19(b) of the Act. Under administrative practice, the legislative policy and functions to which the Commission and its Staff must be committed, under the statute, are such that no presumption of absolute objectivity can reasonably attach to their opinions upon questions of law. Since private rights, on the one hand, and this legislative policy, on the other, always are affected by the legal questions, it is only upon review under Section 19(b) that a judicial weighing of the issues generally or logically is expected. If, during the review procedure, conclusions of law by the administrative agency are not reviewed, there is no step in the regulatory procedure which satisfies requirements of substantive or procedural due process of law.

Thus, in this and other cases, the question of whether the Commission is right or wrong in holding, as a matter of law, that the Act and the Constitution prohibit a decision by it unless "cost-of-service" evidence is presented in proceedings under Section 4(e), is by its nature a question for the Courts of Appeals to decide. If, as occurred below, a reviewing court permits

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service" or other forms of evidence, but for the proposition that ". . . until such time as the present statute is amended to permit such use [of other types of evidence], it is respectfully submitted that the rates of natural-gas companies for sales of gas in interstate commerce for resale must be fixed and determined under the conventional cost-of-service method of rate-making." Brief of Commission Staff Counsel, In the Matter of Alfred C. Glassell, Jr., individually and as co-trustee for Alfred Glassell Comegys Trust, *et al.*, FPC Docket No. G-9278, pp. 42-43 (June 22, 1959).

alteration of decisional grounds, the procedural avenues of Section 19(b), and of Section 10(e) of the Administrative Procedure Act, become mere form, and there is no judicial review of agency conclusions of law.

The holding below is based upon such an alteration and a substitution of decisional grounds by the Court. The Court erred in failing to consider the issues raised by the original decisional grounds set forth in the Commission's order, or, since the Commission abandoned its original grounds, in failing to remand the case for further proceedings before the Commission. *Sunray Mid-Continent Oil Company* v. *Federal Power Commission*, *supra*; *Federal Power Commission* v. *Idaho Power Co.*, 344 U.S. 17 (1952); *Connecticut Light & Power Co.* v. *Federal Power Commission*, 324 U.S. 515 (1945).

III. The Questions are of Utmost Importance in Regulation of the Gas Producing Industry Under the Natural Gas Act and Should be Resolved Promptly.

This Court held in *United Gas Pipe Line Co.* v. *Mobile Gas Service Corp.*, 350 U.S. 332 (1956), that Section 4(e) recognizes that separate, individualized contracts are required by operating conditions and the competitive nature of the natural gas industry. Approximately 10,000 such contracts between producers and pipeline companies have already been filed with the Commission as separate "rate schedules."[24]

[24] FPC Release No. 10,568, G-5562 (PUB), August 12, 1959, reports that between the date of the *Phillips* decision and July 31, 1959, producers had filed 14,770 applications for certificates covering sales. Under the regulations governing producer filings, the sales contract is filed as a rate schedule at the time application is made for a certificate, or prior to commencement of deliveries.

Almost without exception, each of these contracts, or "rate schedules," contains one or more provisions customary in the industry for agreed-upon changes in prices at varying times, in varying amounts, and for varying reasons. Under Commission regulations notice of each such change of price under each contract must be filed as a separate "change" of the "rate schedule," and each such change of price is thus subject to suspension and separate hearing upon reasonableness under Section 4(e). As of July 31, 1959, the Commission reported that there were pending 2,354 suspension cases under Section 4(e) involving price changes by producers.[25]

In each such proceeding the question arises whether, as a matter of law, a so-called "conventional" company-wide "cost-of-service" presentation is required before reasonableness of the one price in issue may be determined, or whether, in Commission discretion, reasonableness of the specific price in question may be determined by more expeditious means available to the Commission and without recourse to the "cost-of-service" formulae.

Numerous and complex regulatory problems before the Commission and the gas producing industry in these producer rate cases arise from the insurmountable difficulty of attempting to apply these formulae to each of thousands of independent producers, and to each of their separate sales and prices. Producers simply are not classic utilities and cannot be fitted into the mold. As the record in this case demonstrates, the producing industry is characterized by multiple ownership of interests in individual leases, and of gas de-

[25] *Ibid.*

livered under the terms and prices in any one contract; by a vast diversity of activities by the owners of production; by arm's-length negotiation of the separate prices for each sale; by the joint production of gas with other commodities not subject to Commission regulation; by a lack of relationship between cost incurrence and sales prices controlled by a competitive market; and, by the practical impossibility of bestowing upon producers' exploration, production, and sales activity, the franchises or other protective devices characteristic of companies to which the "cost-of-service" technique has been applied in the past.

After the *Phillips* decision in 1954, both the gas producing industry and the Commission had anticipated the necessary adaptation of methods of rate regulation to these technical and economic characteristics of the producing industry, as has occurred when other industries first became subject to federal regulation. Unfortunately, such adaptation is now virtually precluded by judicial decisions such as that by the Court below, which are interpreted as limiting the Commission's powers.

The impact of these decisions upon the administration of the Act and upon the producing industry has been a virtual halt of the rate review process. Under the holdings below, each of the many hundreds of pending, limited proceedings under Section 4(e) must become a process of years' duration, while each of hundreds of producers and the Commission's staff attempt to devise a company-wide "cost-of-service" presentation in forms used in proceedings relating to totally dissimilar operations of pipeline companies. In addition, because of interrelations of prices in the fields, pipeline companies' rates, and the rates of com-

panies distributing natural gas to local consumers, prices all the way from the producing fields to the points of consumption in distant states are thus rendered uncertain.

Resolution of the questions of legal limitations upon the Commission's power is, therefore, essential if the Commission is to exercise, with any expedition, the jurisdiction recognized in the *Phillips* decision. If the Commission is to use latitude in rate review under Section 4(e), and may, as have other agencies, adapt the process of regulation to the specific and unchangeable characteristics of the industry regulated, clarification by this Court of the scope of Commission powers is necessary.

Resolution of the second question is of equal importance. Increasingly, in its rate proceedings, the Commission has found it necessary to dispose of questions of statutory construction in applying the Act to the previously unregulated producing industry, and, since the *Mobile* decision, to decide initially questions of contract interpretation and other legal issues. Statutory procedures require the Courts to review, independently, such constructions, constitutional interpretations, and conclusions of law by administrative bodies, where these determinations are challenged. By restriction of inquiry and failure to pass upon such controlling issues of law, reviewing courts cannot exercise their exclusive review jurisdiction, and the substance of due process disappears from review procedures. However, even if the conclusions of law have been made by the Commission during the course of rate review under Section 4(e), adherence by a reviewing court to principles laid down in such cases as *Securities & Exchange Commission* v. *Chenery Corp.*,

supra, must be required. Recent cases under Section 19(b) of the Act, involving independent producers, have been marked by departures from those principles, but none of the objectives of regulatory statutes can warrant this erosion of the bounds of judicial and agency functions so carefully preserved by this Court.

CONCLUSION

For the foregoing reasons, it is respectfully submitted that this Petition for Writ of Certiorari should be granted.

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